IT 98-0093-GIL 12/01/1998 PUBLIC LAW 86-272/NEXUS

General Information Letter: Activities not protected under Public Law 86-272.

December 1, 1998

Dear:

This is in response to your letter dated October 5, 1998, in which you request a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120.

In your letter you have stated as follows:

> A client of xxxxxx xxxxxxxx (hereinafter referred to as “Taxpayer”) requests a general information letter regarding whether it has sufficient nexus with Illinois for both sales and use tax collection and corporate income tax purposes. Taxpayer believes that its actions in Illinois have not risen to a level that would create such nexus and desires a confirmation of this conclusion. The relevant facts and circumstances upon which this ruling is requested are detailed below.
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> FACTS
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> Taxpayer’s primary activity involves mail order sales of its canned software and its only office is located out-of-state. The sales are accepted via telephone orders from customers in various states, including Illinois. The telephone orders are not received in Illinois and the product’s delivery is made through the use of the United States mail or other common carriers. In addition, once a year Taxpayer conducts a one to four day educational seminar in Illinois on specific legal and business issues. Attendees of these seminars are charged a few hundred dollars for their attendance, which includes the cost of materials and any other tangible personal property distributed at the seminar. At such conferences, Taxpayer did not solicit sales or have any sales representatives present, although product literature and brochures were available for attendees to collect. In fact, these seminars are completely unrelated to the software sold and do not provide any training or instructional comment in regard to such software.
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> Aside from these seminars, Taxpayer has had no direct physical presence or contact with Illinois. It has never hired, trained, or supervised personnel in the state. In addition, it has not repaired any property, collected on delinquent accounts, investigated credit worthiness or installed or supervised installation of its products in the state. Moreover, Taxpayer has not provided any kind of technical assistance, resolved customer complaints, approved or accepted orders, repossessed property, secured deposits on sales, or picked up or replaced any damaged or returned property in the state. Furthermore, it does not possess a telephone listing or other public listing within the state and has never entered into a franchising or licensing agreement in Illinois.
>
> ISSUES

Does Taxpayer have nexus in Illinois making it liable for the collection of Illinois sales and use tax on taxable sales made into the state?

Does Taxpayer have nexus in Illinois making it subject to the Illinois corporate income tax?

RULING

Only the issue relating to Illinois income tax has been addressed by this GIL. A response to the sales tax issue will be forwarded under separate cover by the Department's sales tax division.

The determination of whether a taxpayer has nexus with Illinois is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. Such a determination can only be made in the context of an audit where a Department auditor has access to all relevant facts and information. Further, the Department cannot issue Private Letter Rulings to or on behalf of unidentified taxpayers. However, we can provide general information regarding income tax nexus with the State.

1. Constitutional Jurisdiction

The Due Process and Commerce Clauses of the Federal Constitution limit the power of States to subject foreign corporations to tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state (Id.). Unless protected by Public Law 86-272, a foreign corporation has the requisite nexus to subject it to Illinois income tax where any part of its income is allocable to Illinois in accordance with the provisions of Article 3 of the Illinois Income Tax Act (35 ILCS 5/301-304, 308). Illinois Income Tax Regulations state that gross receipts from sales of tangible personal property are allocable to Illinois if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale (86 Ill. Adm. Code 100.3370(c)(1)). In Illinois, canned computer software, as distinguished from custom-made or modified software, is considered tangible personal property (See 35 ILCS 120/2-35).

Because the taxpayer described in your letter sells canned computer software to purchasers in Illinois, a portion of its income would be allocable to Illinois in accordance with the provisions of Article 3 of the IITA. Accordingly, the Federal Constitution does not bar Illinois from subjecting the taxpayer here to Illinois income tax.

2. Public Law 86-272

Public Law 86-272, 73 Stat. 555, 15 U.S.C.A. §381 (1959), denies a State the power to tax net income derived within the State by any person from interstate commerce if the only business activities of such person within the State consist of the "solicitation of orders … for sales of tangible personal property," where the orders are sent outside the State for approval or rejection and are filled by shipment or delivery from a point outside the State. The United States Supreme Court has determined that business activities constituting "solicitation of orders" include activities entirely ancillary to requests for purchases

(Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214, 227, 112 S.Ct. 2447, 2456 (1992)). The Court described ancillary activities as those that serve no independent business function apart from their connection to the solicitation of orders (Id.). Moreover, the Court announced that a taxpayer does not forfeit protection under Public Law 86-272 by engaging in *de minimis* activities that exceed solicitation of orders (Wrigley, 505 U.S. at 231, 112 S.Ct. at 2458).

In addition to its mail order sales of canned computer software, the taxpayer described in your letter conducts on an annual basis within Illinois a one to four day educational seminar covering various legal or business related issues. Attendees pay the taxpayer a fee for their attendance, which includes the cost of materials and other tangible personal property distributed. The taxpayer did not actively solicit sales at these seminars through sales representatives, but product literature was available for attendees to collect.

Based upon these representations, the taxpayer's activities in Illinois associated with the educational seminars cannot be considered entirely ancillary to requests for purchases under the standard set forth by the Court in Wrigley. The taxpayer charged a fee for the service of providing an educational seminar in Illinois. Therefore, its activities associated with the seminar necessarily served a business purpose independent of the solicitation of orders for sales of its canned computer software.

Further, the seminar activities cannot be considered *de minimis* (See Wrigley, 505 U.S. at 231-232, 112 S.Ct. at 2458). Wrigley established that non-qualifying activities may be considered *de minimis* only where those activities are so insignificant that one could not reasonably conclude that by engaging in them the taxpayer had embarked upon another category of business activities beyond solicitation of orders for sales of tangible personal property. In the case of this taxpayer, it would not be unreasonable to conclude that by providing an educational seminar for a fee, the taxpayer had embarked upon another category of business activities in Illinois beyond solicitation for sales of its canned computer software. Accordingly, the seminar related activities cannot be considered *de minimis*.

It was argued against the Court's holding in Wrigley that the effect of carving out an exception in Public Law 86-272 for *de minimis* non-qualifying activities would be to excise the word "only" from the statute. Since Public Law 86-272 protects a taxpayer whose "*only* business activities within such State" are the solicitation of orders, a taxpayer engaged in any magnitude of other activities does not come within the protection of the statute. The Court rejected that argument as erroneous since "the word 'only' places a strict limit upon the *categories* of activities that are covered by § 381, not upon their *substantiality*" (Wrigley, 505 U.S. at 231-232, 112 S.Ct. at 2458 (Emphasis in original)).

Instead, the Court described the test to determine whether an activity is *de minimis* as follows.

> [W]hether in-state activity other than "solicitation of orders" is sufficiently de minimis to avoid loss of the tax immunity conferred by [Public Law 86-272] depends upon whether that activity establishes a nontrivial additional connection with the taxing State.

Applying that analysis to the facts before it, the Court found that the taxpayer's non-qualifying activities, which included the storage, sale, and replacement of relatively small amounts of inventory in the state by local sales representatives, did not fall within the *de minimis* exception. In making that finding, the court explicitly recognized that the relative magnitude of the taxpayer's non-qualifying activities was small compared to its other operations. For example, sales made by sales representatives in the state amounted to only .00007% of total company sales. Similarly, inventory maintained in the state was worth only several thousand dollars. Nonetheless, because the non-qualifying activities were performed by the taxpayer's sales representatives on a continuing basis and in accordance with company policy, it was not unreasonable to conclude that the taxpayer had engaged in another category of business activity beyond solicitation of sales for tangible personal property. Accordingly, the Court determined the non-qualifying activities to be a nontrivial additional connection with the State causing the taxpayer to lose protection under Public Law 86-272.

Applying the same analysis to the facts described in your letter, it would not be unreasonable to conclude that the taxpayer had engaged in another category of business activities beyond solicitation of sales for tangible personal property. In addition to its mail order activities, the taxpayer conducts an educational seminar in Illinois. The seminar is a service provided by the taxpayer in this state for which it charges a fee of hundreds of dollars per attendee, and is held every year over a period of one to four days. Although the revenue and activities of the taxpayer associated with the seminars may be relatively small compared to its total operations, the fact that the activity occurs in a regular and systematic fashion provides a reasonable basis to conclude that the taxpayer has engaged in another category of business activity. For that reason, the seminar activities do not constitute *de minimis* non-qualifying activities, and the taxpayer is not protected by Public Law 86-272.

Thus, the taxpayer in this case will be subject to Illinois income tax on all of its income allocable to Illinois in accordance with Article 3 of the IITA.

As stated above, this is a GIL that does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding upon the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.120 (86 Ill. Adm. Code 1200.120).

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)